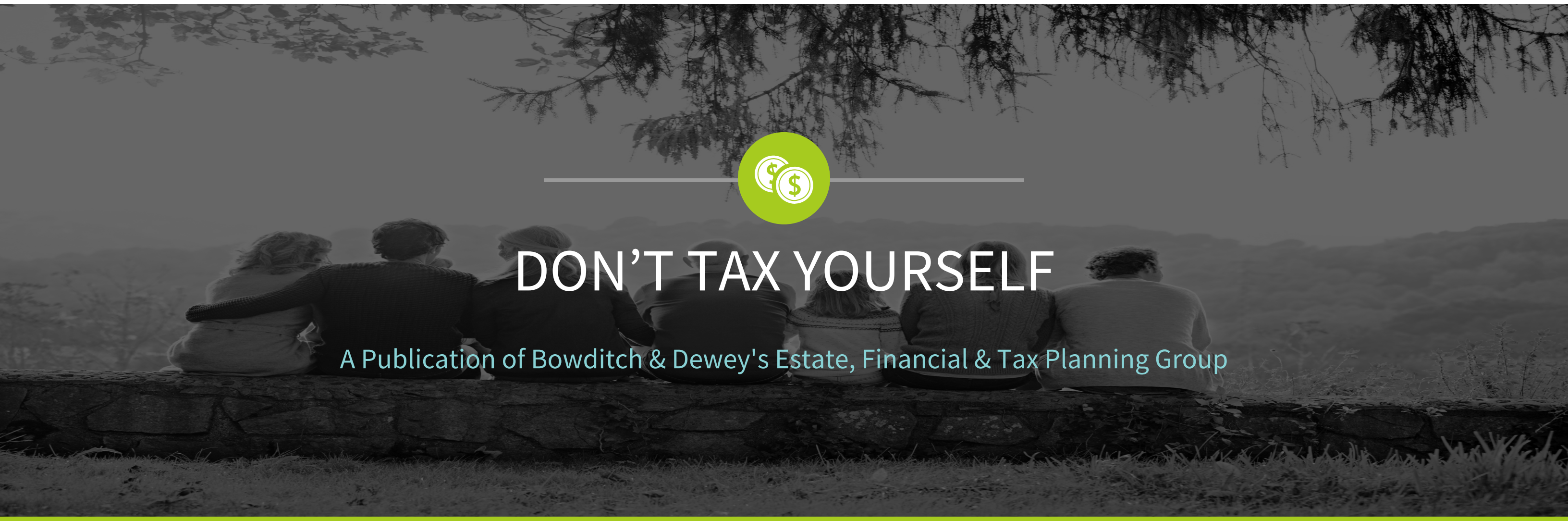

Impact of House Ways and Means Tax Proposals for Trusts, Estates, and Retirement Accounts

BY EILEEN Y. LEE BREGER • SEPTEMBER 29, 2021

In this second blog post on the House Ways and Means Tax proposals, we address the proposed changes that will affect the taxation of trusts, estates, and retirement plans. As we discussed, on September 13, 2021, the Congressional House Ways and Means Committee introduced 880 plus pages of legislative tax proposals to help fund the House's proposed $3.5 trillion stimulus package. Below is a summary of the trust and estate and retirement asset taxation proposals.

1. Trusts and estates with taxable income of over $12,500 (adjusted for inflation) would be taxed at a 39.6% rate, rather than the current top 37% rate.

2. Trusts and estates would also be taxed on capital gains at a top rate of 25% rather than the current 20% capital gains tax rate.

3. Trusts and estates with adjusted gross income ("AGI") over $100,000 would be subject to a 3% surcharge on their income. High-net-worth individuals would be subject to this additional 3% tax on AGI greater than $5 million (for married filing jointly) or $2.5 million (for single taxpayers or married filing separately). The surcharge tax would not apply to a trust if the interests in the trust benefit charitable organizations.

4. The federal estate tax exemption would return to the 2010 amount of $5 million (increased for inflation each year thereafter) from its current $11.7 million. The value reduction for qualified real property used in a family farm would increase from $750,000 to $11,700,000.

5. Contrary to current law, an intentionally defective grantor trust would be treated as part of the grantor's taxable estate for estate tax purposes. In addition, sales between such grantor trusts and their owners would be treated as third-party sales for income tax purposes. However, losses could not be recognized on such related-party sales. Currently, a sale between a grantor trust and its owner is disregarded for income tax purposes.

6. Valuation discounts for lack of marketability or for minority ownership would not apply to the transfer of non-business assets. Currently, the IRS and courts permit such discounts to the fair market value of property for gift tax purposes.

7. Taxpayers with IRA or 401k (or other employer contribution plan) assets more than $10,000,000 could no longer contribute money to their Roth or traditional IRAs, if their AGI exceeds $450,000 (for married filing jointly taxpayers) or $400,000 (for single taxpayers). In addition, taxpayers with IRA and employer contribution plan balances exceeding $10,000,000 would have to take minimum distributions the following year, if the taxpayer's AGI exceeds $450,000 (for married filing jointly taxpayers) or $400,000 (for single taxpayers). This minimum distribution would be 50% of the balance exceeding $10,000,000. Taxpayers with retirement account balances of more than $20,000,000 would also have to distribute the lesser of (a) the amount needed to bring the total balance in all accounts down to $20 million, or (b) their total balances in Roth IRA or Roth 401k/employer contribution accounts.

8. Employers would have to report to the IRS 401(k) balances that are greater than $2.5 million.

9. Taxpayers with AGI of $400,000 or more (or $450,000 or more in the case of married filing jointly taxpayers) would no longer be able to convert tax-deferred IRA or 401k account balances to Roth IRA accounts. In addition, taxpayers could not convert any after-tax contributions made to qualified plans (such as a 401k) to Roth IRA accounts. Currently, taxpayers may convert such tax-deferred IRA or 401k accounts to Roth IRA accounts by paying income tax on the value of the converted 401(k) or IRA balance at the time of its conversion.

10. Taxpayers would no longer be able to use IRA assets to invest in private securities offered only to accredited investors. IRAs holding such investments would lose their IRA status. A two-year transition period for IRAs holding these investments would be provided.

11. Taxpayers would no longer be able to invest IRA assets in a non-publicly traded entity if the taxpayer owns 10% or more in the entity or if the taxpayer is an officer or director of such entity. If the taxpayer does so, the IRA would cease to be an IRA. Currently, an IRA owner may not invest in a non-publicly traded entity if the taxpayer owns more than 50% of the entity. A two-year transition period for IRAs holding such investments would also apply to this proposal.

12. Charitable contributions by a partnership in a conservation easement transaction would no longer be treated as tax-deductible if the amount the partnership contributes is greater than 2.5 times the sum of each partner's relevant basis in the partnership (e.g., their basis in the real property involved in the easement transaction). Accuracy-related penalties of 40% of the underpayment of tax would apply to such transactions and no defense based on reasonable cause would be allowed. In addition, the requirement for supervisory approval of a penalty assessment would no longer apply to these transactions. The proposal would be effective for contributions made after December 23, 2016, or after December 23, 2018 (for contributions to preserve a certified historic structure).
    Currently, taxpayers may take a tax deduction for the contribution of a qualified real property interest (such as land for public enjoyment or historically significant property) to a qualified organization (such as a non-profit organization for conservation purposes). A higher contribution limit is also allowed in calculating the charitable tax deduction for such conservation easements.
    The IRS issued Notice 2017-10, however, to designate certain syndicated conservation easement transactions as listed transactions. These transactions involved charitable contribution deductions that were significantly greater than the amount the taxpayer invested.

The House has not yet voted on the above-proposed legislation. If passed, the increased tax cost of holding assets in trust means that trustees need to revisit how often they distribute trust assets to beneficiaries to minimize overall taxation. In addition, private funds that have investors who invest their IRA assets in such funds could be significantly impacted. Please talk with your tax advisor if you have questions about any of the above proposals.

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